

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

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May 5 2003

IN THE MATTER OF APPLICATION OF KENTUCKY)
POWER COMPANY D/B/A AMERICAN ELECTRIC)
POWER FOR APPROVAL, TO THE EXTENT)
NECESSARY, TO TRANSFER FUNCTIONAL)
CONTROL OF TRANSMISSION FACILITIES)
LOCATED IN KENTUCKY TO PJM)
INTERCONNECTON, L.L.C. PURSUANT TO KRS)
278.218

CASE NO. 2002-00475

**POST-HEARING BRIEF OF
KENTUCKY POWER COMPANY D/B/A
AMERICAN ELECTRIC POWER**

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**KENTUCKY POWER COMPANY'S
POST-HEARING BRIEF**

VI. INTRODUCTION

In this case, Kentucky Power Company ("KPCO" or "the Company") has applied, pursuant to KRS 278.218, for approval, to the extent necessary, of its plan to transfer functional control of its transmission facilities to PJM Interconnection, L.L.C. ("PJM"), a Regional Transmission Organization ("RTO") approved by the Federal Energy Regulatory Commission ("FERC").¹ The Commission should grant such approval because the evidence submitted in this case by the Company and PJM demonstrates that such a transfer is for a lawful purpose and is consistent with the public interest. No evidence to the contrary has been submitted.

VII. BACKGROUND

KPCO is a public utility providing electric service to about 170,000 customers in eastern Kentucky. KPCO's provision of retail electric service is regulated by this Commission under KRS Chapter 278. KPCO is an operating company of the American Electric Power ("AEP") System, a multistate electric utility holding company system registered under the Public Utility

¹ KRS 278.218, which was recently enacted, requires Commission approval of the transfer of control by a regulated public utility, of utility facilities. The Commission's statutory authority in this regard may be preempted by FERC's

Holding Company Act of 1935. The AEP System is planned and operated as an integrated system, providing electric service to about five million customers in parts of eleven states. AEP owns an extensive electric transmission system, which it uses to serve its customers, and to provide transmission service pursuant to an Open Access Transmission Tariff (OATT) as required by FERC.

An RTO is a regional entity, independent of transmission-owning utilities and other market participants, that exercises functional control over its member transmission owners' transmission facilities, offers open-access transmission service over those facilities at a single rate, and acts as reliability authority for the region. In Order No. 2000,² FERC has determined that RTOs will improve electric reliability and enhance competition in wholesale electricity markets by assuring non-discriminatory access to transmission facilities. Order No. 2000 also specifies the characteristics and functions necessary for any RTO.

AEP, as a condition of the FERC's approval, in June 2000, of its merger with the former Central and South West Corporation (CSW) is required to transfer functional control of its transmission facilities to an RTO. In addition, FERC, in Order No. 2000, has strongly encouraged transmission-owning utilities to join RTOs, and, more recently, in Docket No. RM01-12-000, has issued a proposed rule requiring utilities to participate in an RTO or other independent transmission provider. JCB at 2.³ FERC's recent SMD White Paper also proposes to require RTO membership.

regulation of transmission under the Federal Power Act, 16 U.S.C. §824, *et seq.* KPCO is therefore seeking approval to the extent such approval may legally be required.

² *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000).

³ In this brief initial pre-filed testimony will be referred to by the initials of the witness, e.g. JCB; and hearing testimony by Company witnesses will be referred to by the witness' initials followed by "Tr." for transcript, e.g. JCB Tr. _____. The hearing testimony of PJM witnesses will be referred to by the witness' last name and Tr., e.g. Hinkle Tr. _____.

Since the merger order, AEP has taken steps to transfer functional control of its transmission facilities to an RTO.⁴ From 1999 through 2001, AEP and several other companies pursued development of the Alliance RTO, which was envisioned as an independent transmission company (“ITC”). FERC encouraged the Alliance formation effort, but in a December 2001 Order reversed course and found the proposed Alliance RTO non-compliant with FERC Order No. 2000. JCB at 3-4. Thereafter, AEP and the other Alliance participants pursued a combination with the Midwest ISO (“MISO”), a FERC approved RTO with members in several Midwestern states. When negotiations proved unsuccessful, AEP evaluated its options for RTO membership, which were: 1) joining the MISO as an individual transmission owner; 2) joining the MISO as part of an ITC involving other former Alliance Companies; 3) joining PJM individually; or 4) joining PJM as part of an ITC. *Id.*

AEP chose to join PJM. AEP entered into a Memorandum of Understanding (“MOU”) with PJM indicating its intent to participate, and another MOU with PJM, National Grid Company, USA, Commonwealth Edison Company and Illinois Power Company, reflecting the intent of the companies to participate in PJM as an ITC. The second MOU provided, however, that if conditions for formation of the ITC were not satisfied, AEP and the other companies would join PJM as individual transmission owners. JCB at 6.⁵

FERC approved AEP and the other new PJM Companies’ RTO choices in a July 31, 2002 order, subject to certain conditions, including: 1) development of a joint and common market between PJM and the MISO by October 1, 2004; 2) tariff changes to allow ITCs to operate within PJM; 3) approval by the North American Electric Reliability Council (“NERC”)

⁴ AEP’s transmission system is divided into east and west pricing zones. KPCO’s facilities are in the east zone. JCB at 2-3. This brief will focus on AEP’s RTO activities relating to its east zone facilities.

⁵ In fact, the conditions for such ITC formation did not materialize, and AEP has no present plans to participate in PJM as part of an ITC.

of a joint PJM/MISO reliability plan; 4) development of a rate for service within the combined PJM/MISO region at a single charge; 5) a joint operational plan to address alleged isolation of utilities in Michigan and Wisconsin and other “seams” issues and 6) reporting by MISO and PJM on their common market. JCB at p. 6.

Later, in an Order dated April 1, 2003, FERC accepted various tariff changes and documents necessary for AEP and the other companies’ participation in PJM.⁶ In the meantime, FERC’s conditions are being addressed. PJM and MISO have entered into a Letter of Intent to rapidly develop a single market, and are reporting monthly to FERC on their progress. Proceedings are underway at FERC for the development of a single MISO/PJM rate, and settlement discussions are underway to address the Michigan and Wisconsin issues. JCB at 7.

AEP originally intended to transfer functional control of transmission facilities to PJM on February 1, 2003 and to be fully integrated into PJM’s markets by May 1, 2003. However, AEP’s participation has been delayed by several legal and regulatory reasons, including the passage of a law by the Virginia legislature prohibiting transfer of control of transmission facilities to an RTO any earlier than July 1, 2004. PJM has indicated that, in light of such delays and for operational reasons, transfer of functional control cannot occur any earlier than October, 2003. Despite such delays, AEP continues to request that the Commission decide this case expeditiously. It is important that AEP have in place all requested approvals to transfer control.

III. PROCEDURAL HISTORY

KPCO filed this case on December 19, 2002. Included in the Company’s filing is the direct testimony of J. Craig Baker, Senior Vice President – Public Policy and Regulation for American Electric Power Service Corporation. Mr. Baker has thirty-five years of experience in

⁶ 103 FERC ¶ 61,008 (2003). This order had not been issued at the time of the hearing in this case. A copy is attached.

the electric utility industry. A major focus of Mr. Baker's activities since 1998 has been AEP's RTO participation. JCB at 1-2. On February 20, 2003, PJM intervened in this proceeding, and on March 14, 2003, PJM submitted direct testimony of Andrew L. Ott, Executive Director of PJM's Market Services Division and Robert O. Hinkle, General Manager of RTO Integration and Coordination.

The Kentucky Attorney General's Office ("Attorney General") and the Kentucky Industrial Utility Customers ("KIUC") intervened on February 21, 2003 and January 16, 2003, respectively. The Attorney General and KIUC have not filed testimony in this proceeding.

AEP and PJM responded to discovery from the Commission staff and intervenors, and an informal conference was held February 25, 2003 to discuss initial discovery responses. The staff submitted follow-up discovery, which AEP and PJM responded to on March 7, 2003. A hearing was held at the Commission's offices on March 25, 2003. At the hearing, the Commission directed AEP and PJM to supply certain additional data, and provided for the filing of simultaneous post-hearing briefs. AEP provided the supplemental data on April 10, 2003, and herewith submits its post-hearing brief.

IV. REASONS FOR GRANTING APPLICATION

The Commission should grant KPCO's application for approval to transfer functional control of its transmission facilities to PJM because the testimony and exhibits submitted by AEP and PJM demonstrate that such a transfer is for a lawful purpose and is consistent with the public interest. In fact, under recognized principles of administrative law, the Commission should grant the application because there is no evidence in the record that would support any other outcome. No other participant submitted evidence. Since a Commission decision must be supported by substantial evidence, there would appear to be no basis for denial of the

application. *See, American Beauty Homes Corporation v. Louisville & Jefferson County Planning & Zoning Commission*, Ky., 379 S.W.2d 450, 456 (1964) (“Unless action taken by an administrative agency is supported by substantial evidence it is arbitrary”); *Crouch v. Police Merit Board*, Ky., 773 S.W.2d 461, 464 (1988) (agency action not supported by substantial evidence is arbitrary and clearly erroneous.)

In discovery and at the hearing, the Commission staff and intervenors expressed some concerns that AEP’s participation in PJM could adversely affect the Company’s ability to continue to provide adequate service at reasonable prices to native load customers. That is a legitimate concern; however, as discussed later in this brief, the record in this case should satisfy the Commission that Kentucky Power’s ability to continue to serve its customers at the lowest reasonable price will in no manner be compromised by participation in PJM.

A. Description of PJM

PJM has a 75 year history operating the electric transmission grid in the eastern United States since 1927, first as an association of transmission owners but more recently, as an independent operator of the grid with its own Board and governance structure. Since January 1, 1998, PJM has served as the independent system operator, as approved by orders of the FERC, for all or part of the states of New Jersey, Delaware, Maryland, Pennsylvania, Virginia, and the District of Columbia. On December 20, 2002, FERC approved PJM as an RTO, and the FERC approved the expansion of PJM through several orders in 2001 and 2002. In all the areas it serves, PJM’s mission is to promote the safe and reliable operation of the bulk power facilities in the PJM region, the creation and operation of a robust, competitive, and non-discriminatory electric power market in the PJM region, and to avoid undue influence over the operation of the bulk power facilities by any market participant or group of market participants. As discussed

below, PJM uses a security-constrained economic dispatch coupled with voluntary energy markets and reliability criteria to provide a reliable and competitive wholesale market. PJM's Board is made up of independent individual representatives from different specialties and includes a former state regulator. Hinkle at 3-4.

B. AEP's reasons for Joining PJM

As indicated above, AEP, as a condition of its merger, must join an RTO.⁷ AEP's choices for its east zone facilities were to join PJM or MISO, either individually or as part of an ITC. AEP chose PJM for the following reasons:

- 1) PJM has already in operation, a state-of-the art market, including day-ahead and real-time energy, imbalance and ancillary service markets, and price discovery. As expanded the PJM market will encompass over 150,000 MW of generating capacity.
- 2) The Kanawha-Matt Funk congestion point, which has been a problem area due to siting delays in AEP's plans to reinforce its system and other constraints in the southeast portion of the AEP system, will be addressed in a comprehensive manner by PJM, because the systems most affected – AEP, Virginia Power and Allegheny Power System – are, or plan to be, in PJM.
- 3) PJM has proven experience in integrating new members into the PJM footprint in an expedited and cost effective manner.

⁷ Staff counsel suggested through cross-examination of Mr. Baker that AEP's participation in an RTO was voluntary. It is true that AEP agreed as part of a stipulation with FERC Staff in the merger case to join an RTO; but it was (and is) the FERC's policy to condition merger approval on RTO membership to remedy what it perceives as "transmission market power", *See, e.g. Ohio Edison Co., et al.*, 81 FERC ¶ 61, 110 (1997). Since there was no question that the merger would be conditioned upon RTO membership, AEP's agreement to join an RTO cannot realistically be regarded as voluntary. JCB Tr. 63-64.

- 4) AEP's affiliation with PJM will provide access to PJM's already-approved congestion management, market mitigation and market monitoring systems in an expedited manner.
- 5) PJM will provide deep independence. Transmission owner control will not be an issue.
- 6) PJM's ancillary service and energy imbalance markets are conducive to retail electric choice. Although retail electric choice is not available in Kentucky, three of the seven states in AEP's east zone have adopted retail choice and AEP must address the issue. PJM has substantial experience in performing RTO functions.
- 7) PJM's congestion management system, featuring locational marginal pricing ("LMP"), will significantly improve the congestion management system currently being used in the AEP system and will limit or eliminate reliance on transmission loading relief (TLR) procedures, thus eliminating the perception by some that TLRs are used in a discriminatory manner. JCB at 7-8.

C. Benefits of PJM

1. Reliability Benefits

Mr. Baker testified that Kentucky Power's participation in PJM, as part of the integrated AEP System, will benefit Kentucky electric customers by improving the reliability and competitiveness of interstate wholesale energy markets, and, greatly expand the generation sources economically available to Kentucky customers.

Mr. Baker also noted that Kentucky Power's participation in PJM, as part of the integrated AEP System, will improve service reliability by consolidating in one entity transmission reliability functions that formerly were performed by several utilities and control

areas. This consolidation of functions will necessarily improve coordination and communication in matters relating to the operation of the regional transmission system. JCB at 11.

In addition, PJM, will have exclusive authority for maintaining the security and reliability of the transmission grid. PJM will serve as NERC's Reliability Coordinator for the expanded PJM region and will direct control area operations of its participants. In this regard, it will engage in transmission system security monitoring, coordinate with other security coordinators, implement reliability procedures, direct responses to emergency situations and provide congestion clearing solutions as necessary to maintain a secure transmission system. (*Id.*)

Mr. Hinkle expanded on the reliability benefits. He pointed out that PJM ensures short-term reliability by: 1) receiving, confirming, and implementing all interchange schedules; 2) ordering redispatch of generators connected to PJM-controlled transmission facilities; 3) approving all scheduled outages of transmission facilities; 4) scheduling generator maintenance outages; 5) monitoring the electrical system on a real-time basis, 6) implementing emergency procedures as required to maintain system reliability; and 7) serving as the NERC Reliability Coordinator for the PJM/PJM West region. Attachment C to Mr. Hinkle's testimony (Operations Summary Summer 2002) shows that PJM met and exceeded NERC performance standards (CPS 1 and 2) for the peak summer months of June and July 2002. Hinkle at 12.

Mr. Hinkle went on to describe how PJM maintains long-term reliability through its regional planning process. PJM conducts a regional generation and transmission planning process that is open and transparent and that is expressly focused on the public interest and consumer benefits. Looking forward, PJM's open and non-discriminatory planning process will

identify and facilitate the most efficient changes to the bulk power market-regardless of whether those are generation solutions, transmission solutions, or demand response solutions. PJM has no financial interest in any of those approaches and will not favor one over any other.

Regional planning with Midwest ISO will be coordinated in order to allow stakeholders to have regular input. Hinkle at 13-14.

2. Market Benefits

In addition to enhancing reliability of electric service, KPCO's participation in PJM will enhance the efficiency and competitiveness of wholesale energy markets. PJM operates a large and liquid wholesale energy market. The PJM West hub liquidity exceeded 20,000 GWh in the third quarter 2002. *See* Attachment B to Mr. Hinkle's testimony. PJM's day-ahead market allows market participants to lock-in their sale and purchase prices a day in advance. Moreover, the PJM market provides the foundation for further customer-oriented advances. For example, as noted above, PJM has implemented a demand response program, with both emergency and economic components, that is integrated with the regional energy market. Qualified participants, by reducing load, can provide the same benefit to the grid as a generator that produces energy, and therefore can receive similar LMP-based payments under the economic demand response program. Hinkle at 9-10.

As noted above, the PJM market will encompass over 150,000 MW of generation. JCB at 7. As part of the AEP system, Kentucky Power buys power and energy when needed, or when economic, from the wholesale markets and sells temporarily excess generation in those same markets. Access to such a large, competitive market will enhance the Company's sale and purchase options.

The competitiveness of PJM's markets is further assured by PJM's independent governance structure. As Mr. Hinkle pointed out, PJM's independent Board of Managers has, as one of its primary mandates, the responsibility to ensure that no market participant or group of market participants has undue influence over the operation of the bulk power facilities or markets in the PJM region. Hinkle at 6. Mr. Hinkle also pointed out that state public service commissioners and their staffs actively participate in PJM's stakeholder processes and that the current PJM member commissions are involved in discussions with the new state commissions about how to interact with PJM in the future. (*Id.*)

Mr. Hinkle testified that PJM's well-established stakeholder process gives electric market participants and other stakeholders a voice in market and reliability issues. Equally important, the independence of the PJM board assures that no market participant receives an undue advantage. Hinkle at. 7.

The competitiveness of PJM's markets is also enhanced by an efficient and non-discriminatory generator interconnection process, and an independent, FERC-approved market monitoring function. Hinkle at 15-16.

PJM uses LMPs calculated in the wholesale energy market as an economic means of managing transmission congestion. LMP is an effective congestion management tool because it sends price signals that alleviate congestion by providing effective signals that allow the market participants to respond efficiently.

The LMP system should significantly improve the congestion management system currently used for AEP, by limiting or eliminating reliance of transmission loading relief ("TLR") procedures, which have been criticized as inefficient and potentially discriminatory. JCB at. 8.

Some concern has been expressed about load serving entities, such as Kentucky Power, potentially experiencing congestion costs under the LMP system. As discussed more fully in the following section, the Company believes that it and its customers will be adequately protected against such costs.

V. STAFF AND INTERVENOR CONCERNS

As indicated above, pre-hearing procedures and questions at the hearing indicated some concerns regarding AEP's planned participation in PJM. These concerns appeared to be centered around 1) changes in AEP operations due to assumption of control over transmission and generation by PJM; 2) increased congestion costs as a result of PJM's LMP congestion management system; 3) increased costs due to PJM's adequacy requirement; 4) lack of a cost-benefit analysis by AEP; 5) participant funding for new generator interconnections and 6) curtailment priority for native load customers under KRS 278.214. While such concerns are certainly understandable, the Company believes that they have been adequately addressed on the record. None of the issues raised presents the prospect that Kentucky Power's participation in PJM will significantly increase Kentucky customers' costs or decrease their reliability of service. In short, while customers can benefit from the Company's participation in PJM, as described above, it is unlikely that they will be harmed by such participation.

A. Voluntary Nature of PJM's Markets

The Commission should not be concerned that joining PJM will change AEP's operations to the detriment of Kentucky retail customers. In fact, PJM is structured to allow its transmission-owning members' operations and service to native load to remain largely unchanged. The key is that PJM's energy markets are totally *voluntary*. As explained by PJM witness Ott, PJM runs a security-constrained dispatch, with voluntary spot markets. Ott at 3.

Each wholesale customer can elect either to participate in the spot market that is created through the economic dispatch, or can elect to self-supply or bilaterally purchase energy to meet demand (*Id.*)

Thus, although AEP's generators will nominally be dispatched by PJM, AEP will be able to self-schedule its generation to meet its load, just as it does today. Further, AEP will be able to pursue bilateral power purchases and sales outside of PJM's markets. AEP is not obligated to use the PJM spot market, but has the option to do so, should it prove beneficial. Further, Mr. Ott testified that the transparency of information provided by the spot market prices enables market participants to make better economic choices in meeting their supply and demand needs. Ott at 4.

Counsel for the KIUC, apparently acknowledging that by participating in PJM, AEP will not be ceding control over its generation to PJM (beyond its ability to order redispatch and to coordinate outage schedules, traits that are common to all RTOs), nevertheless pursued a line of cross examination suggesting that PJM could, in the future, request FERC to give it more control over generation, to the detriment of retail customers. JCB Tr. at 32-34. Mr. Baker pointed out that any such proposal would have to run the gauntlet of PJM's stakeholder process, FERC filing with rights of intervention by interested parties and possible court review. JCB Tr. at 33. With due respect to the KIUC, the Company has to make decisions on the basis of existing regulatory requirements and conditions, not on hypothetical concerns about the future. There is no indication that PJM plans such an expansion of its authority, and AEP would certainly oppose any such expansion if it could in any way harm AEP's retail customers.

B. Ability to Hedge Congestion Costs

Mr. Ott also addressed concerns about increased congestion costs resulting from PJM's LMP congestion management system:

In a non-market based system, when utilities experience congestion on their transmission system, they redispatch generation in order to clear the congestion. The costs of that redispatch are traditionally borne by the company's retail and wholesale customers through fuel adjustment clauses, contractual arrangements for wholesale customers and through base rate changes. If congestion is caused by unscheduled power transfers, utilities will utilize NERC's TLR procedures to curtail power flows. Ott at 4-5.

Financial Transmission Rights ("FTRs") are part of the LMP congestion management system. FTRs are, in essence, an insurance policy which protects the holder from incurring the costs of congestion over a given transmission path. PJM allocates FTRs to Network and Firm Point-to-Point transmission customers, including a utility's native load customers. FTRs are allocated to these native load customers to recognize that they have paid the fixed cost of the transmission facilities through their payments of transmission service demand charges. These FTRs are allocated to the firm transmission customers based on a set of allocation rules that allow the customers to request FTRs from their generation resources to their demand locations. Since transmission congestion charges are determined by differences in locational prices between a customer's generation resources and demand locations, FTRs act as a hedge against the payment of these congestion costs. Typically, load-serving entities can use a transmission congestion hedging strategy that includes bilateral energy contracts and FTRs to protect themselves against incurring congestion charges. PJM will be implementing an auction system for FTRs but will continue to ensure protection for native load customers by allocating to

customers the revenue proceeds from the auction. In this way, an entity serving native load customers can protect those customers from incurring any additional costs from congestion.

PJM's market analysis shows AEP receiving more money from FTRs that it experiences in congestion costs (Attachment A to Ott Testimony, p. 11). Since congestion has not been a major problem on the AEP transmission system, AEP is inclined to accept PJM's assumption that it will not result in significant unhedged costs to AEP. JCB Tr. at 31.

C. Generation Adequacy

Another concern addressed at the Hearing relates to PJM's requirement that load-serving entities carry specified level of reserves. Counsel for KIUC suggested that such a requirement could impose major costs on Kentucky Power. JCB Tr. at 39. However, Kentucky Power already has a responsibility to maintain adequate resources to fulfill its duty to serve native load. The Commission, in fact, monitors the Company's compliance with that responsibility through the Integrated Resource Planning process. Mr. Baker testified that he did not expect any major cost impact from the PJM generation adequacy requirement, since the type of reserve levels required by PJM are not inconsistent with what AEP regards as necessary to maintain reliability and economic supplies (*Id.*).

D. Costs vs. Benefits

Since congestion management and generation adequacy costs are not expected to significantly increase, the remaining major cost to join PJM is the annual administrative charge. Kentucky Power's share is estimated to be about \$3 million annually. To put that number in perspective, it represents less than one tenth of one percent of the Company's annual operating expense of \$336 million dollars.⁸

⁸ The figure is from Kentucky Power's consolidated financial statement for the 12 months ending December, 2002. AEP is also seeking from FERC accounting treatment that would allow AEP to defer RTO formation costs, so that

The Company was asked in discovery and at the Hearing whether it had performed a cost/benefit analysis to support its decision to join PJM. No such formal analysis was performed. A cost/benefit analysis is a management tool that, among many others, can be used to guide management decisions. As the Commission recently noted in its order on AEP's Environmental Compliance Plan "a cost benefit analysis is only one of several alternatives that can be used in evaluating alternatives."⁹ A cost/benefit analysis is not appropriate for every occasion, and the absence of such an analysis does not render a decision imprudent. Cost/benefit analyses are most appropriate when deciding whether or not to take a particular action. In this case, AEP must join an RTO. Not joining is not an alternative.

Although AEP did not perform a cost/benefit analysis, PJM performed a market analysis, which was sponsored by Mr. Ott. PJM's analysis clearly shows the potential for savings or additional sales revenues for AEP substantially in excess of PJM's administrative charges. Mr. Ott's analysis indicates a range of net benefits of \$61 million dollars to \$80 million dollars based on a range of assumptions. The \$61 million represents a scenario in which all AEP generation is bid into and all requirements are taken from the spot market. The \$81 million represents a scenario in which all transactions are bilateral. Ott Tr. at 159-160; Attachment B to Ott Testimony, p. 8). While the second scenario represents a closer approximation of how AEP is likely to operate under PJM, either scenario shows benefits far in excess of the projected AEP system-wide administrative fee of \$45 million dollars (of which Kentucky Power's share is \$3 million).

they can eventually be recoverable from retail customers. Kentucky Power's share of such amortized costs is likely to be relatively small.

⁹ The Application of Kentucky Power d/b/a American Electric Power for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend its Environmental Cost Recovery Surcharge Tariff, Case No. 2002-00169, Order, March 31, 2003.

AEP cannot, of course, vouch for PJM's analysis, but it appears to confirm, at least directionally, AEP's belief that there will be benefits from joining PJM to offset administrative costs. JCB Tr. at 12.

E. Merchant Generation

The Commission staff pursued a line of questioning regarding whether PJM's generator interconnection policy would comply with Paragraph (2) of KRS 278.212, which states that costs associated with transmission system upgrades caused by the addition of a merchant generating facility must be borne by the person building the generating facility. JCB Tr. at 13. Mr. Hinkle testified on cross-examination that in the case of transmission system upgrades caused solely by the addition of a new generator, the costs are assigned by PJM to the generator. Hinkle Tr. at 80. The cost of "baseline" transmission upgrades that are built to respond to general load growth is rolled in and carried by all transmission customers. Hinkle Tr. at 114-115. Of \$726 million in transmission upgrade investments in the PJM region since 1999, \$200 million was for baseline upgrades, and the remaining \$526 million was associated with the addition of new generating units, with the costs assigned to the generation owners. Hinkle Tr. at 138-139. Thus, PJM's generator interconnection procedures are consistent with KRS 278.212.

F. Native Load Priority

The Staff also asked questions of AEP and PJM about whether PJM would comply with KRS 278.214, which gives highest curtailment priority to Kentucky native load customers. Mr. Hinkle testified that under the PJM tariff, network service (typically used to serve native load) and firm transmission service must be curtailed on a pro-rata basis. Hinkle Tr. at 75. So, there may be some inconsistency between KRS 278.214 and the PJM OATT. However, PJM's tariff

in this regard is consistent with FERC's pro-forma tariff. This inconsistency between federal and state law will therefore exist whether or not AEP joins PJM.¹⁰

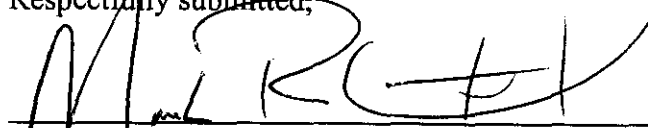
Besides being unavoidable, the record reflects that this inconsistency is unlikely to be a serious problem. Mr. Hinkle testified that emergency curtailments of electric use, should they occur, are much more likely to be the result of generating capacity shortages than transmission problems. Hinkle Tr. at 100. He also testified that since firm transmission service typically is not used to serve native load (because it would involve duplicate charges), it is unlikely that native load customers in the east would be favored over those in Kentucky. Hinkle Tr. at 73-74. Finally, Mr. Baker testified that AEP's response to emergency transmission situations would essentially be the same under PJM as it is today. That is, AEP would take the actions needed to address the emergency, without regard to favoring customers in one state or another. If anything, emergency response may be improved by having an entity monitoring a wider area. JCB Tr. at 67-68.

VI. CONCLUSION

Kentucky Power has demonstrated that its planned participation in PJM, as part of the integrated AEP System, is for a proper purpose and consistent with the public interest. The Commission should approve the application.

¹⁰ Kentucky Power pointed out in a brief filed March 14, 2003 in Case No. 2002-00349, that there are serious constitutional problems with KRS 278.214.

Respectfully submitted,



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CERTIFICATE OF SERVICE

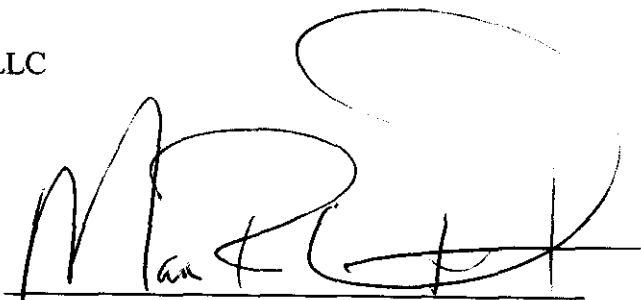
I hereby certify that a true and accurate copy of the foregoing Post-Hearing Brief of Kentucky Power Company was served by Regular U.S. Mail, postage prepaid on the 5th day of May, 2003 upon:

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